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SUBJECT: KAZAKHSTAN: THE UPWARD TRENDS OF TENGIZCHEVROIL

REF: ASTANA 0131

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¶1. (U) Sensitive but unclassified. Not for public Internet.

¶2. (SBU) SUMMARY: On February 20, Jay Johnson, Chevron's Managing Director for Eurasia (protect), briefed the Ambassador on the latest plans and projects of Tengizchevroil (TCO), in which Chevron owns 50 percent, ExxonMobil 25 percent, KazMunaiGas (KMG) 20 percent, and LukArco 5 percent. Johnson said that oil production at Tengiz, the largest producing oil field in Kazakhstan, is expected to increase from 17 million tons in 2008 to 25 million tons in 2009, due to the installation of a \$3 billion sour gas injection plant. Johnson provided an update on TCO's export transportation options, local content investments, atmospheric emissions, and sulfur storage and sales. He also disclosed that if the price of Brent crude drops below \$40 a barrel, Chevron "will have real cash flow problems" and may have to defer capital investments. END SUMMARY.

TCO HAS PAID \$30 BILLION TO KAZAKHSTAN SINCE 1993

¶3. (SBU) Johnson delivered a comprehensive, end-of-year briefing to the Ambassador, which he said he also delivered the day before to Deputy Prime Minister Umirzak Shukeyev and Minister of Energy Sauat Mynbayev. He said he normally begins presentations with a discussion of safety issues, but Kazakhstani government officials prefer him instead to begin with TCO's contribution to the state budget. In 2008, TCO paid \$7 billion to the government of Kazakhstan in taxes and royalties, shareholder distributions, and rail and pipeline tariffs, a significant increase over the \$4 billion paid in 2007. In addition, TCO paid another \$1 billion in 2008 for employee salaries and goods and services procured in Kazakhstan. Overall, since 1993, TCO has paid more than \$30 billion to Kazakhstan, approximately 90 percent of which has gone to the central government, according to Johnson.

PRODUCTION JUMPS DUE TO SOUR GAS INJECTION

14. (SBU) Following a seven-year period of steady output averaging 12 million tons of crude production per year, Johnson reported that TCO dramatically increased production in 2008, when its sour gas injection plant became operational. (NOTE: Re-injecting associated gas into the well has a dual benefit: it maintains the pressure necessary to push oil up and out, and it keeps the high-sulfur gas in the ground, thereby reducing the need to store and transport as much dry sulfur. On February 17, TCO shut down operations at the sour gas injection plant "due to a hydrocarbon leak through flange DHS-F-10-10, which is a closed drain vessel in the hydrocarbon system." Normal production resumed the next day. END NOTE). In 2008, TCO produced approximately 17 million tons, but Johnson said he expects production in 2009 to reach 25 million tons.

#### CRUDE EXPORT ROUTES AT MAXIMUM CAPACITY

15. (SBU) According to Johnson, all westward export routes from Tengiz will be at maximum capacity by this summer. As previously reported (reftel), TCO currently ships most of its crude via the Caspian Pipeline Consortium (CPC) pipeline and is eager to expand its capacity from 33 million tons to 67 million tons. TCO also swaps up to 2 million tons per year via the Atyrau-Samara pipeline, but as Johnson explained, "we lose in two ways when we go that route. First," he said, "there is no quality bank, which means we ship high-quality Tengiz crude and pick up lower-quality Urals blend on the other side. Second, our crude is actually lighter than the Urals blend, so we get less total volume than we put in."

#### CHEVRON BELIEVES KCTS WILL HELP CPC EXPANSION

16. (SBU) Johnson said he is concerned about the complexity of the Kazakhstan Caspian Transportation System (KCTS), but confirmed that Chevron supports the project, "if only to help us negotiate with the Russians to expand CPC. That's still not a done deal," he cautioned, "and every little bit of leverage helps." Johnson said

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that TCO currently ships small volumes of Tengiz crude from Baku to Tbilisi via the Baku-Tbilisi-Ceyhan (BTC) pipeline. TCO only uses about five percent of BTC's capacity -- approximately 50,000 barrels per day -- due to the high mercaptan content of Tengiz crude. According to Johnson, higher volumes would "pass the tipping point and corrupt" the rest of the crude in the pipeline. Johnson also said that when TCO ships crude from Azerbaijan to Georgia's Black Sea ports by rail, it is required to deliver 50 percent to Batumi, which is owned and operated by KMG, and 50 percent to Kulevi, owned and operated by SOCAR. "Unfortunately," Johnson said, "there is a sunken barge blocking access to the port of Kulevi, so that terminal is not currently operational." Johnson said he did not know if the barge was a casualty of Georgia's conflict with Russia, or if it sank for other reasons.

#### TCO TOUTS LOCAL CONTENT

17. (SBU) Johnson proudly described TCO's investments in local capacity and local contractors, telling the Ambassador that more than 82 percent of TCO staff are Kazakhstani, including 73 percent of TCO's managers and supervisors. Johnson complained mildly that many of their most promising managers are hired by KMG directly, but he said Minister of Energy Mynbayev and other senior officials consider this a normal part of building local capacity. Johnson also noted that TCO currently employs virtually no ethnic Uzbeks or Kyrgyz and the company has replaced nearly all of its Turkish workers with Kazakhstanis. He said that since 1995, TCO has purchased more than \$7 billion of goods and services from Kazakhstani suppliers, including \$1.3 billion to 515 "legitimate local companies" in 2008. "Unlike some of our competitors, we don't create artificial companies to meet local content requirements. We only count procurement as local content if the item was manufactured or assembled in Kazakhstan," he said.

#### FINES GO UP AS EMISSIONS GO DOWN

18. (SBU) Johnson said that in 2008, TCO paid more than \$90 million in fines and penalties for atmospheric emissions, a 55 percent increase over the previous year. According to Johnson, TCO's

emissions decreased from 70,000 tons in 2003 to 50,000 tons in 2007, while fines and penalties increased from \$10 million to \$50 million over that same period, as a result of changes to the government's formula. Of the \$90 million TCO paid in 2008, Johnson said that \$30 million covers the company's normative (i.e., expected) emissions, and as such will go to the regional (oblast) government. The balance comprises a \$30 million fee for emissions above TCO's "normative" level and a \$30 million penalty; both payments will be made to the central government.

#### TCO INCREASES SULFUR SALES TO KAZAKHSTANI CUSTOMERS

19. (SBU) According to Johnson, in 2008, TCO sold 2.23 million metric tons of sulfur, or 131 percent of total 2008 production, despite the collapse of the global sulfur market and a drop in price from more than \$700 per ton to less than \$60 per ton. He told the Ambassador that TCO has signed protocols of intent for long-term sulfur sales to four projects in Kazakhstan:

- 60,000 tons to Kazatomprom (KAP)'s operations in Stepnogorsk (start up date, 2010)
- 180,000 tons to KAP's subsidiary, the Stepnogorsk Mining Chemical Plant (2011)
- 160,000 tons to KAP's joint venture with Inkai (2012)
- 900,000 tons to Sunkar Resources Aktobe (2010)

In addition, Johnson said that TCO is in discussions with KazPhosphat and its potential industrial partners for a long-term sulfur sales supply agreement of 170,000 tons per year.

10. (SBU) COMMENT: Jay Johnson is a former general director of

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Tengizchevroil and one of the most knowledgeable and experienced oil men working in Kazakhstan. He is the first representative of a major oil company to say that future project expansion may be jeopardized if oil falls below \$40 a barrel. Given the extreme expense of oil exploration in Kazakhstan, the steady fall in the price of oil, and the global economic environment, one has to wonder how deep the pockets of the majors really are. At some point, perhaps soon, projects that require massive capital investment such as Kashagan, Tengiz, and Karachaganak may suffer a slowdown. Even ExxonMobil, which reported a record profit of more than \$40 billion in 2008, last week withdrew its resident manager for new business development, several months before his scheduled departure, and does not plan to name a replacement. END COMMENT.

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